Office of the
Comptroller of the Currency

The Perspectives of Prudential Supervisors on Examination Issues

IIB Seminar

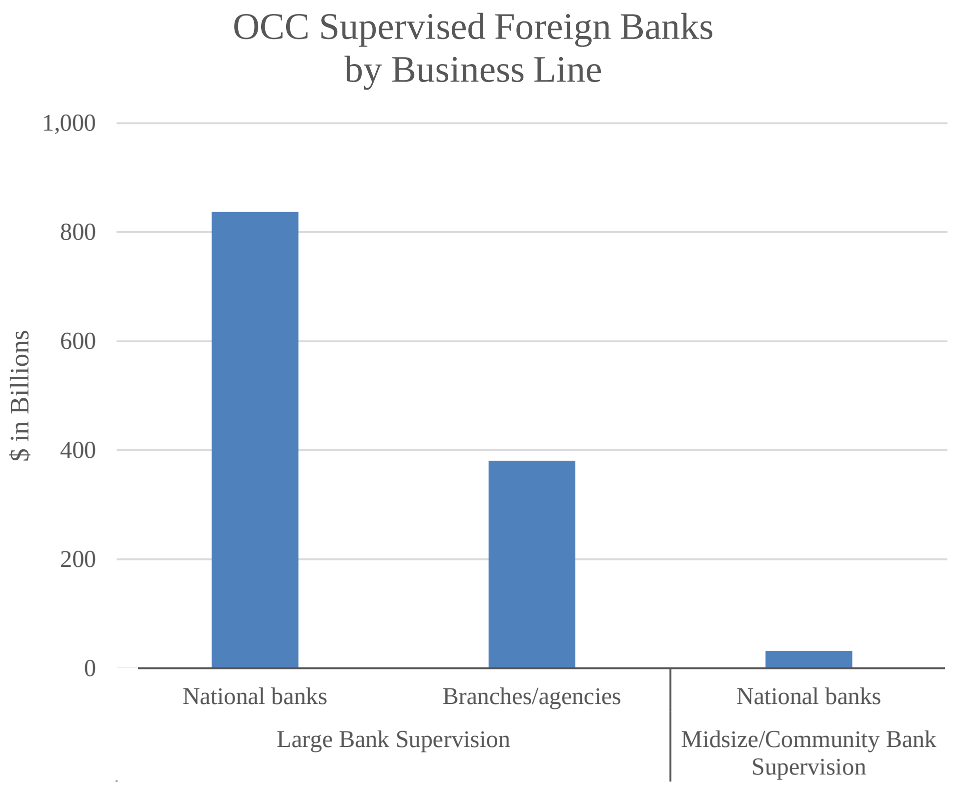
October 17, 2017

Agenda

- OCC Supervision of Foreign Banks
  - Key Institutions
  - Supervision Structure
- Semiannual Risk Perspective
  - Key Risk Themes and Priorities
- International Banking Supervision
  - Matters Requiring Attention

OCC Supervision of Foreign Banks

- **Supervised Entities**
- **Supervision Structure**



Note: Total banking assets of OCC supervised foreign owned banks are $1.2 trillion. Data as of June 30, 2017.

Semiannual Risk Perspective
National Risk Committee (NRC)

Spring 2017

https://www.occ.gov/publications/publications-by-type/other-publications-reports/semiannual-risk-perspective/semiannual-risk-perspective-spring-2017.pdf

Key Risk Themes

Strategic	Strategic risk is elevated as management teams consider M&A, business model changes, and the potential need to adapt in an uncertain regulatory climate. Management teams are searching for sustainable ways to generate target rates of return in a persistent low interest rate environment.
Credit	Competitive pressures and strong credit risk appetites have driven easing in underwriting standards and increased credit risk for some loan portfolios.
Operational	Operational risk is high as banks adapt business models, transform technology and operating processes, and respond to increasing cybersecurity threats.
Compliance	Compliance risk remains high as banks continue to manage money laundering risks subject to resource constraints in an increasingly complex risk environment, and implement changes to policies and procedures to comply with amended consumer protection requirements.

Key Risk Themes - Strategic

Strategic Risk

- Strategic risk **continues to be concentrated in midsize and community banks searching for revenue and market niches**.
- While strategic risk **remains elevated for the majority of large banks,** these banks **continue to improve the effectiveness** of their processes and controls to address strategic risk.
- **Strategic planning remains important** as banks adopt and implement innovative products, services, and processes in response to the evolving demands for financial services and the entrance of new competitors. Directors and management should comprehensively **understand the benefits and risks** of strategic changes before implementation.
- **Merger and acquisition activity is expected to continue** as midsize and community banks seek to maximize shareholder or franchise value, gain economies of scale, increase market penetration, and improve efficiencies.
- **Net interest margins are likely to remain under pressure** for banks with extended asset maturities. As rates increase, banks should be aware of the implication for earnings.

Key Risk Themes - Credit

Credit Risk

- **Banks continue to incrementally ease underwriting practices** across a variety of commercial and retail credit products to boost or maintain loan volume and respond to competition from bank and nonbank lenders.

- **Supervisory reviews continue to identify concerns** regarding the quality of CRE loan underwriting and concentration risk management, including weaknesses in stress testing CRE portfolios, establishing appropriate concentration limits, and implementing adequate concentration management information systems.

- **Increased auto-lending risk** from years of strong growth and eased underwriting standards is now materializing in the lagging delinquency and loss severity indicators. These lagging indicators are likely to continue to increase as loans with more aggressive underwriting mature.

- **Weaknesses have been identified in the ALLL methodologies** at some banks, with examiners identifying lack of appropriate consideration of strong loan growth, rising concentrations of credit, and increasing risk appetite and tolerance for underwriting exceptions.

Key Risk Themes - Operational

Operational Risk

- **Sophisticated cyber threats continue to pose high inherent risks** to an interconnected financial service marketplace.

- **Cyber threats are increasing in speed and sophistication.** These threats target large quantities of PII and proprietary intellectual property, and facilitate misappropriation of funds. **Phishing** is the primary method for breaching data systems and often the entry mechanism to perpetrate other malicious activity.

- **Timely and thorough software patch and update management, strong risk-based authentication, sound controls, and effective user awareness campaigns and training help banks** avoid phishing, ransomware attacks, and viruses, and mitigate other risks.

- There has been a **significant increase in the volume of IT-related MRAs** identified during supervisory activities of MCBS banks and TSPs. The top five categories of concern (77% of MRAs) involve information security, IT governance/oversight, business continuity, third-party risk management, and IT audit.

Key Risk Themes - Operational

Operational Risk (Continued)

- **The number, nature, and complexity of third-party relationships continue to expand**, increasing risk management challenges for banks. Consolidation among service providers has **increased third-party concentration risk**.

- **Control breakdowns in the governance of product sales, delivery, and service continue** to elevate levels of operational risk and can erode trust in the banking system. Effective risk management promotes timely detection, response, and escalation of operational issues.

- **Volume of products/services and the complexity of end-to-end processes** for delivery in large, complex banks **is a key driver of high operational risk**. **Insufficient monitoring and limited internal testing have failed** to detect product/service delivery disruptions, resulting in slowed response by banks and elongated impact for customers.

- **Central clearing of derivative contracts through central counterparties has helped to increase transparency and reduce bilateral counterparty risk**. These benefits have come at the expense of increased concentration, liquidity, and operational risks.

Key Risk Themes - Compliance

Compliance Risk

- **BSA/AML compliance risks remain high**. The inability to develop and maintain requisite expertise to successfully implement BSA/AML controls increases the scale of vulnerabilities created by technological developments and innovation.

- **Bank decisions to terminate entire categories of customer accounts without considering the risk** presented by individual customers or the bank's ability to manage the identified risk **may facilitate the movement** of certain customer segments or transactions **out of the regulated financial system**. This reduces transparency and potential reporting to law enforcement authorities, as required by the BSA. Higher-risk customer relationships may instead migrate **to other banks less experienced** in managing complex transactions and potential money laundering risks.

- **Evolving consumer compliance risks and increasing complexity of the risk environment present significant challenges** for bank compliance risk management systems. Increased compliance costs and the resultant pressures place additional demands on already strained systems. Maintaining sufficient compliance expertise to manage the additional risks and complexities remains a concern.

- **Change management challenges continue** as banks work to implement new and revised consumer protection rules.

- **Fair lending risks may increase when banks engage third parties** to conduct some or all of the loan application or underwriting processes, or to help banks make decisions regarding terms or pricing.

Key Risks - Large Banks

Key Risks

- **Enterprise risk governance weaknesses** increase operational, reputation, and compliance risks and impede prevention, identification, and timely resolution of issues resulting in increased likelihood of poor customer service experiences.
- The **volume of products/services and the complexity of end-to-end processes for delivery is a key driver of high operational risk**. Without strong business, risk management, and audit processes this increases the likelihood of not delivering products and services as intended.
- **Consumer compliance risk management and change management requires attention** given persistent challenges in meeting compliance management expectations for existing regulations and changes in regulations.
- **BSA/AML risk management is an area of emphasis** due to controls at some banks not keeping pace with higher-risk services and customer relationships.
- **Cybersecurity and fraud continues to pose risk** from the increasing volume and sophistication of cyber threats and IT vulnerabilities.
- **IT planning and infrastructure is increasingly important** due to weaknesses in IT strategic planning in prior years that will take time to correct through the establishment of stronger processes.

Key Risks - Midsize and Community Banks

Key Risks

- **Cyber resiliency** is increasingly important as threats from malware and cyber extortion become more complex as many banks increasingly rely on third parties to provide critical activities.
- **Commercial and retail credit underwriting standards** have eased over the past several years as banks strive to increase or maintain loan volumes in an increasingly competitive environment.
- **CRE loan concentrations** have increased given the strong growth in income producing CRE loans over the past three years.
- **BSA/AML compliance** is increasingly challenging as banks adapt risk management systems to keep pace with evolving risks and the increasing complexity of the risk environment.
- **Consumer compliance risk management systems** have not kept pace with evolving risks and the increasing complexity of the risk environment. The implementation of requirements pose challenges to bank systems, policies and procedures, disclosures, and staff training.
- **Strategic planning and governance risk** continues to pose a challenge as banks implement plans for adapting business models to respond to changing loan demand, low interest rates, and intense competitive pressures, including competition from nonbanks.

International Banking Supervision

International Banking Supervision

- The OCC's International Banking Supervision Division
  - Part of Large Bank Supervision
  - Located in New York
  - Responsible for the oversight of 53 institutions
- Portfolios broken out by geography
  - Europe and Asia
  - Americas, Middle East, Africa, Australia
- Primary issues include elevated BSA/AML risk and concerns with related risk management systems.

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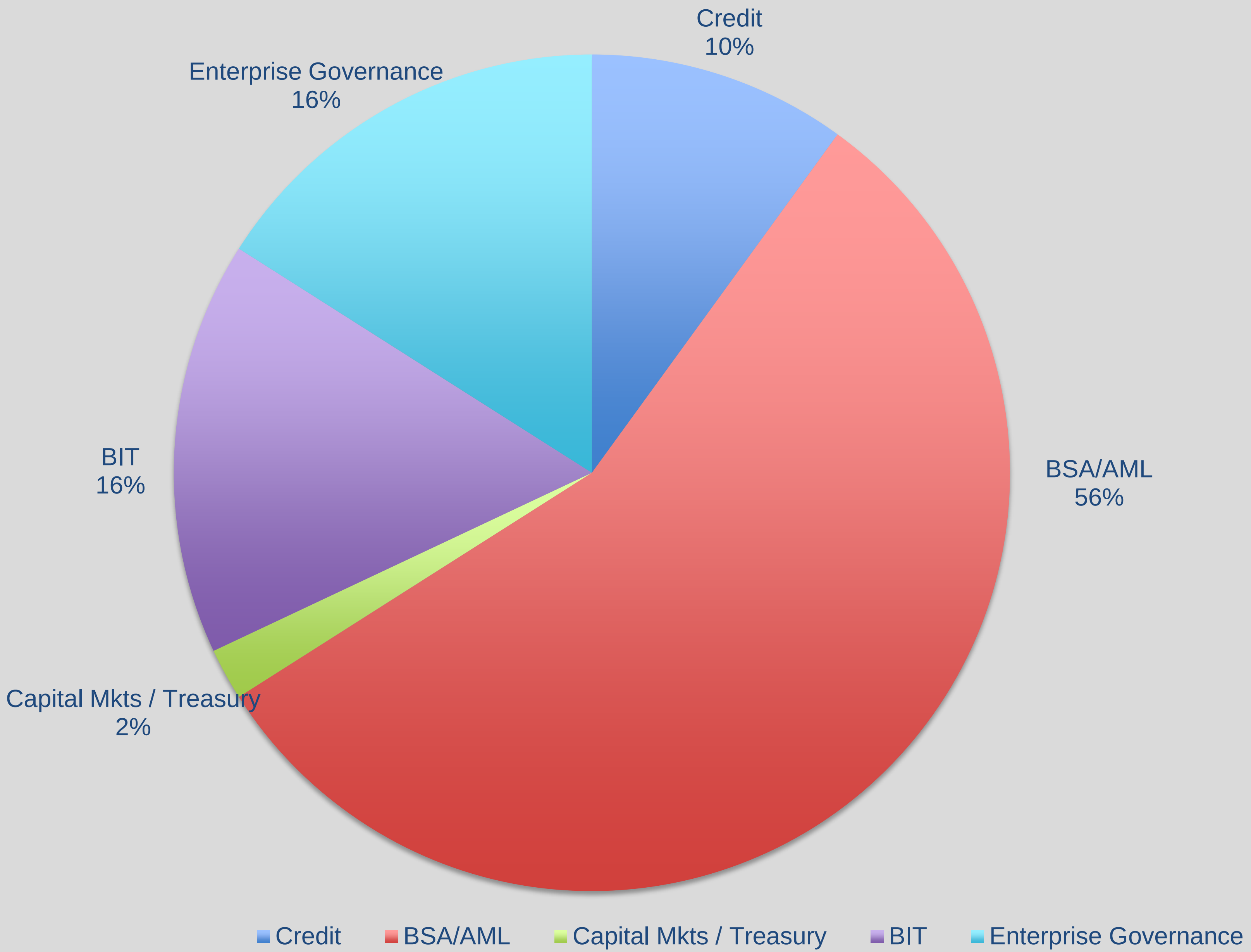
Outstanding MRAs by Core Function



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